

Internal Revenue Service  
Director, Exempt Organizations

Department of the Treasury  
P.O. Box 2508 - EP/EO  
Cincinnati, OH 45201

Date:

OCT 02 2001

Employer Identification Number:

Person to Contact - I.D. Number:

Contact Telephone Numbers:

Dear Sir or Madam:

We have considered your application for exemption from Federal income tax under the provisions of section 501(c)(3) of the Internal Revenue Code of 1986 and its Regulations. Based on the available information, we have determined that you do not qualify for the exemption. Enclosure I.

Consideration was given to whether you qualify for exemption under other subsections of section 501(c) of the Code. However, we have concluded that you do not qualify under another subsection.

As your organization has not established exemption from Federal income tax, it will be necessary for you to file an annual income tax return on Form 1041 if you are a Trust, or Form 1120 if you are a corporation or an unincorporated association. Contributions to you are not deductible under section 170 of the Code.

If you are in agreement with our proposed denial, please sign and return one copy of the enclosed Form 6018, Consent to Proposed Adverse Action.

You have the right to protest this proposed determination if you believe it is incorrect. To protest, you should submit a written appeal giving the facts, law and other information to support your position as explained in the enclosed Publication 892, "Exempt Organizations Appeal Procedures for Unagreed Issues." The appeal must be submitted within 30 days from the date of this letter and must be signed by one of your principal officers. You may request a hearing with a member of the office of the Regional Director of Appeals when you file your appeal. If a hearing is requested, you will be contacted to arrange a date for it. The hearing may be held at the Regional Office or, if you request, at any mutually convenient District Office. If you are to be represented by someone who is not one of your principal officers, he or she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements as set forth in Section 601.502 of the Statement of Procedural Rules. See Treasury Department Circular No. 230.

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If you do not protest this proposed determination in a timely manner,-- it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Internal Revenue Code provides, in part, that:

A declaratory judgement or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the district court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within the time specified, this will become our final determination. In that event, appropriate State officials will be notified of this action in accordance with the provisions of section 6104(c) of the Code.

Sincerely,

*Steven P. Miller*

Director, Exempt Organizations

Enclosures: 3



FACTS

Your organization has submitted an organizing document adopted by your Board on [REDACTED]. Your purpose as stated in your organizing document is that you are established exclusively for charitable purposes, including, for such purposes, making of distributions to the organization that qualify as exempt organizations under section (to be determined). This document has not been filed with the State and to our knowledge, there are no other governing instruments. You stated in your letter dated [REDACTED] that you are not a corporation; you are a sole proprietorship.

To carry out your purpose you propose to conduct the following activities:

- a. Constructing [REDACTED] is your primary activity. The [REDACTED] are made with people's loved ones name on them and then placed in [REDACTED]. Each [REDACTED] will also have your [REDACTED]. You make the [REDACTED] at cost. The [REDACTED] are then sold to the general public. The selling of the [REDACTED] is part of your fund raising. Your charitable purpose is to give the money raised by selling memorial items to needy families in your area.
- b. A [REDACTED] race called "[REDACTED]" will be a fundraising activity. All proceeds will go to area children and their families in [REDACTED]. Based on the information in the flyer attached to your application you will charge the following fees:
  1. Race Fees - \$[REDACTED] per class, day of races
  2. Race Fees - \$[REDACTED] per class if pre-registered
  3. Gate Fees - \$[REDACTED] or \$5 and a new toy
- c. Making memorial rocks is your other planned activity.

You stated that yourself, [REDACTED] and other family members would conduct all activity. You have indicated that it is questionable as to whether you or other board members will be compensated. You have, however allowed for salaries in your proposed budgets for the years [REDACTED] and [REDACTED].

Substantially all of your financial support will come from the selling of [REDACTED] and other [REDACTED] and an annual [REDACTED] race.

Law

Section 501(c)(3) of the code provides for the exemption of organizations organized and operated exclusively for "charitable" purposes.

Section 1.501(c)(3)-1(e)(1) of the regulations provides that an organization may meet the requirements of section 501(c)(3), although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized and operated for the primary purpose of carrying on a unrelated trade or business, as defined in section 513 of the Code. This section further provides that an organization that is organized and operated for the primary purpose of carrying an unrelated trade or business is not exempt under section 501(c)(3) even though it has certain charitable purposes, its property held in common, and its profits do not inure to the benefit of individual members of the organization.



Section 511(a) of the code imposes a tax on the unrelated business taxable income of certain organizations which are otherwise exempt from tax under section 501(a) of the Code, which is derived from any unrelated trade or business regularly carried on by such organizations.

Section 513(a) of the Code defines "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational or other purpose or function constituting the basis for its exemption under section 501, with certain exceptions not here relevant. It further provides that the term "trade or business" has the same meaning it has in section 162, and generally includes any activity carried on for the production of income from the sale of goods or the performance of services.

Section 1.513-1(a) of the regulations states, in part, the income of an exempt organization is subject to the tax imposed by section 511 of the Code if three conditions are present with respect to such income: (1) the income must be from a trade or business, (2) the trade or business must be regularly carried on by the organization, and (3) the trade or business is not substantially related (aside from the need of the organization for income or funds or the use it makes of the profits derived) to the exercise or performance by the organization of the purpose or function which constitutes the basis for its exemption from tax.

Section 1.513-1(b) of the regulations provides that the term "trade or business" has the same meaning it has in section 162, and generally includes any activity carried on for the production of income from the sale of goods or performance of services. It is further provided that activities of producing or distributing goods or performing services from which a particular amount of gross income is derived do not lose identity as trade or business merely because they are carried on within a larger complex of other endeavors which may, or may not, be related to the exempt purpose of the organization.

Section 1.513-1(d)(1) of the regulations provides that gross income derives from "unrelated trade or business", within the meaning of section 513(a), if the conduct of the trade or business which produces the income is not substantially related (other than through the production of funds) to the purposes for which exemption is granted. The presence of this requirement necessitates an examination of the relationship between the business activities which generate the particular income in question—the activities, that is, of producing or distributing the goods or performing the services involved—and the accomplishment of the organization's exempt purposes.

Section 1.513-1(d)(2) of the regulations provides that trade or business is "related" to exempt purposes, in the relevant sense, only where the conduct of the business activities has causal relationship to the achievement of exempt purposes (other than through the production of income); and it is substantially related; for purposes of section 513, only if the causal relationship is a substantial one. Thus, for the conduct of trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes. Where the production or distribution of the goods or the performance of the services does not contribute importantly to the accomplishment of the exempt purposes of an organization, the income from the sale of the goods or the performance of the services does not derive from the conduct of related trade or business. Whether activities productive of gross income contribute importantly to the accomplishment of any purpose for which an organization is granted exemption depends in each case upon the facts and circumstances involved.

An organization is not operated exclusively for charitable purposes, and thus will not qualify for exemption under section 501(c)(3), if it has a single non-charitable purpose that is substantial in nature. This is true regardless of the number or importance of the organizations' charitable purposes. Better Business Bureau v. United States, 326 U.S. 278 (1947); Stevens Bros. Foundation, Inc. v. Commissioner, 324 F.2d 633 (8<sup>th</sup> Cir. 1963), aff'd, 39 T.C. 93 (1962), Cert. Denied, 376 U.S. 969 (1964).



[REDACTED]

In Revenue Ruling 73-105, 1973-1 C.B. 264, it was held that the sale of scientific books and city souvenirs by a museum of folk art exempt from tax under section 501(c)(3) of the Code constituted unrelated trade or business even though other items sold in the museum shop was related to its exempt function. This ruling suggested considering separately each item sold by the museum shop to determine the item's relatedness to the museum's exempt function of enhancing the public's understanding and appreciation of art. The ruling noted that scientific book and souvenir items relating to the city where the museum was located had no causal relationship to art or to artistic endeavor and, therefore, the sale of those items did not contribute importantly to the accomplishments of the museum's exempt educational purpose. The fact that some of these items could, in a different context, have been held related to the exempt educational purpose of some other exempt educational organization did not change the conclusion that, in this context, they did not contribute to the accomplishment of this organization's exempt educational purpose.

### Conclusion

In order to qualify for exemption under section 501(c)(3) of the Code, you must establish that you are organized and operated exclusively for religious, charitable, or educational purposes and that no part of your net earnings inure to the benefit of a private individual or shareholder.

You have failed to establish that your primary activity, the making and selling [REDACTED] is other than an ordinary trade or business regularly carried on for the production of income and substantially unrelated to any exclusively religious, educational, or otherwise charitable purpose within the meaning of section 501(c)(3) of the code. You have stated that one purpose of this activity, which consumes all your time with the exception of [REDACTED] which consumes a small amount of time, is to produce the income needed to conduct your other activities consisting making donations to needy families. The only causal relationship between your non-charitable business activities and your other purported exempt functions is that the [REDACTED] will produce income that is needed in order to conduct your other activities. Section 513(a) as the Code provides that the business activity must be substantially related aside from the need of the organization for income or funds or the use it makes of the profits derived.

Because your primary activity, the sale of [REDACTED], and [REDACTED] is a non-charitable purpose that is substantial in nature, and you have failed to establish that your activities are otherwise exclusively religious, charitable or educational in nature, you do not qualify as an organization described in section 501 (c)(3) of the Code. See, Better Business Bureau, cited above.



Department of the Treasury - Internal Revenue Service  
Consent to Proposed Adverse Action  
(All references are to the Internal Revenue Code)

Case Number [REDACTED]	Date of Latest Determination Letter
Employer Identification Number [REDACTED]	Date of Proposed Adverse Action Letter OCT 02 2001

Name and Address of Organization  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]

I consent to the proposed adverse action relative to the above organization as shown below. I understand that if Section 7428, Declaratory Judgements Relating to Status and Classification of Organizations under Section 501(c)(3), etc. applies, I have the right to protest the proposed adverse action.

NATURE OF ADVERSE ACTION

- ☒ Denial of exemption
- ☐ Revocation of exemption, effective.
- ☐ Modification of exemption from section 501(c)( ) to section 501(c)( ), effective
- ☐ Classification as a private foundation described in section 509(a), effective \*\*\*\*
- ☐ Classification as an private operating foundation described in sections 509(a) and 4942(j)(3), effective for
- ☐ Classification as an organization described in section 509(a)( ), effective
- ☐ Classification as an organization described in section 170(b)(1)(A)( ), effective

If you agree to the adverse action shown above, please sign and return this consent. You should keep a copy for your records.

If you sign this consent before you have exhausted your administrative appeal rights, you may lose your rights to a declaratory judgement under section 7428.

(Signature instructions on Back)

Name of Organization:  
[REDACTED]

Signature and Title

Date

Signature and Title

Date